

Lecture 1

Introduction to Economic Psychology

Dr Cillian McHugh

PS4168: Economic Psychology

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Economic Psychology is Everywhere

Economic Psychology is Everywhere

<https://www.youtube.com/embed/KbbZc2pab9k>

Economic Psychology is Everywhere

- In pairs/groups identify examples of Economic Psychology

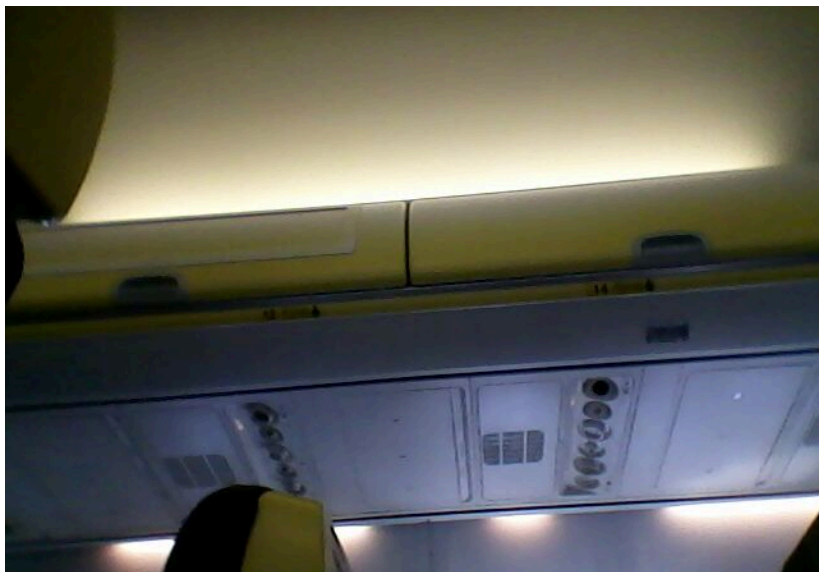
Before we begin

- Can you think of anything that influences people's decisions?

Before we begin



Before we begin



Overview

- General Information and Housekeeping
- Topics to be covered
- Introduction to Economic Psychology

General Information and Housekeeping

Module Leader	Dr Cillian McHugh
Email	cillian.mchugh@ul.ie
Office	KBG-22
Student Hours	Wednesdays, 11-12 (book an appointment here)
Lecture location	P1003
Day and Time	Wednesdays, 9-11

Lectures

- 2 hour slot (Wednesday mornings)
- Interactive (discussion + activities)
- Will be recorded
- Do not come in if you are sick!!!

Core Texts



Altman (2017)

Camerer, Loewenstein, & Rabin (2003)



Cartwright (2014)

Economic
Psychology



Ranyard (2018)

- Additional readings will be highlighted during lectures

Assessment

Type of Assessment	% of Final Grade	Deadline
Task 1	25%	Wednesday 18th October at 4pm
Task 2	30%	Wednesday 8th November at 4pm
Exam	45%	Exam Week (1 hour)

Topics to be covered

Topics to be covered

Theories of Decision
Making
Heuristics and Biases
Game Theory
Nudges and Other
Contextual Influences
Future Decisions and
Affective Forecasting

Emotional Influences
Loss Aversion/Risk
Aversion and Endowment
Effects
Mental Accounting
Fairness and Ethics
Gambling

Activity: [\(link here\)](#)

Theories of Decision
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Introduction to Economic Psychology

Defining Economic Psychology

- “The science of economic mental life and behaviour” (Ranyard, 2018, p. 5)
- The study of “how individuals affect the economy and how the economy affects individuals” (Lea, Tarpy, & Webley, 1987, p. 2; see Ranyard, 2018, p. 5)
- Branch of *Applied Psychology* (Ranyard, 2018)
- **Interdisciplinary**
 - Psychology
 - Behavioural Economics

Homo Economicus and the Standard Economic Model

- *Homo Economicus*:

- a rational individual
- makes rational decisions
- that maximize utility
- is self-interested
- capable of learning from experience
- stable, consistent preferences (Ranyard, 2018, p. 6; Cartwright, 2014; see also Lea et al., 1987; Wärneryd, 2008)

Behavioural Economics & Economic Psychology

- Adam Smith
 - *An Inquiry into the Causes of the Wealth of Nations* (1776)
 - *The Theory of Moral Sentiments* (1759)
 - invisible hand of the market
- Vilfredo Pareto (1897)
 - “Pure political economy has therefore a great interest in relying as little as possible on the domain of psychology”

(Cartwright, 2014)

Behavioural Economics Reborn

- Herbert Simon
 - “Bounded Rationality” (1955)
 - Questioned the logic of the Standard Economic Model
- Daniel Kahneman and Amos Tversky
 - Evidence against the Standard Economic Model

Evidence Against Standard Economic Model

- A bat and ball cost €1.10 in total. The bat costs €1.00 more than the ball. How much does the ball cost? _____ cents

Evidence Against Standard Economic Model

- A bat and ball cost €1.10 in total. The bat costs €1.00 more than the ball. How much does the ball cost? _____ cents
 - Correct answer: 5 cent

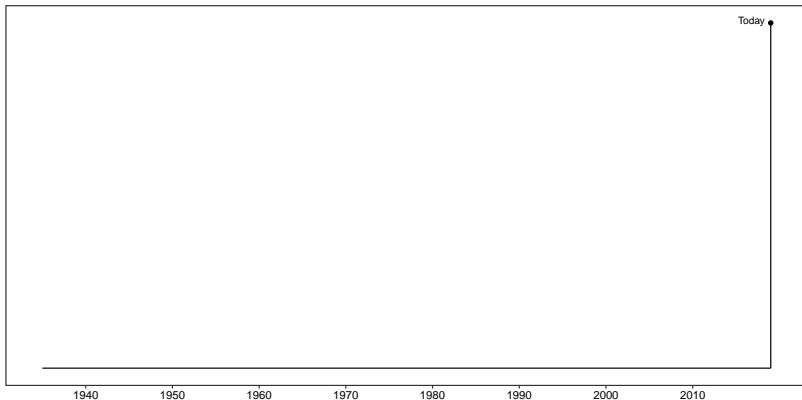
Behavioural Economics Reborn (contd)

- Vernon Smith
 - Markets Work
- Reinhard Selten
 - multiple equilibria

Early Emergence of Economic Psychology

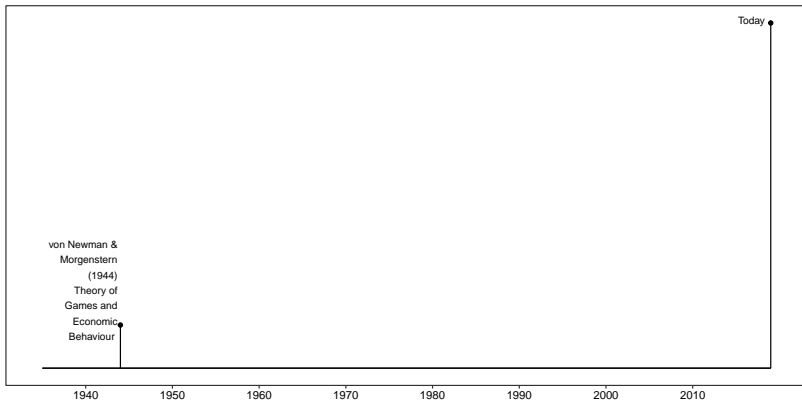
- Adam Smith (1723 – 1790)
 - “we suffer more . . . when we fall from a better to a worse situation than we ever enjoy when we rise from a worse to a better” (Smith, 1759, p. 311; see Camerer et al., 2003, p. 5)
- Jeremy Bentham (1748–1832)
 - Building on Smith’s concept of self-love developed the concept of utility and calculations to maximise utility (Camerer et al., 2003; Ranyard, 2018)
- John Stuart Mill (1806–1873)
 - Conceived *homo economicus* (see Ranyard, 2018)
 - Preference for a larger gain over a smaller gain

Emergence of Economic Psychology



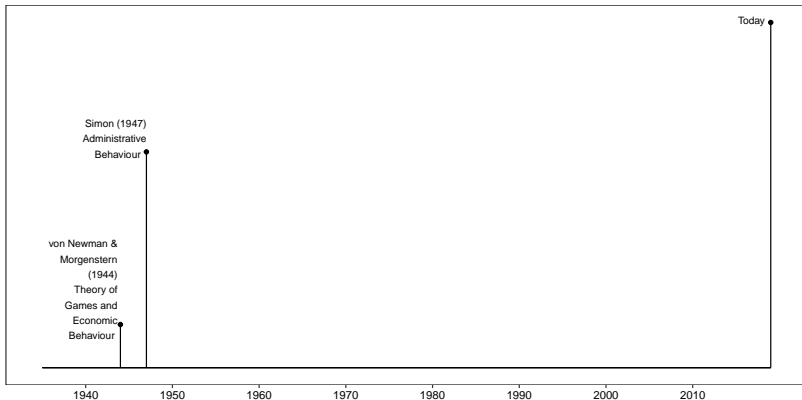
- Timeline of recent emergence of Economic Psychology

Emergence of Economic Psychology



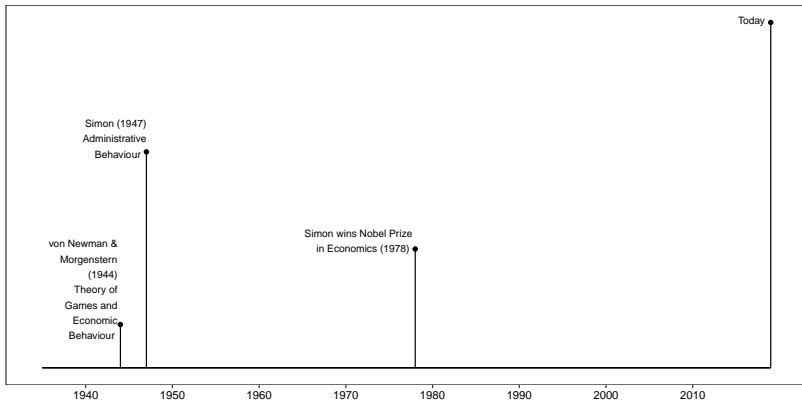
■ Early Publication

Emergence of Economic Psychology



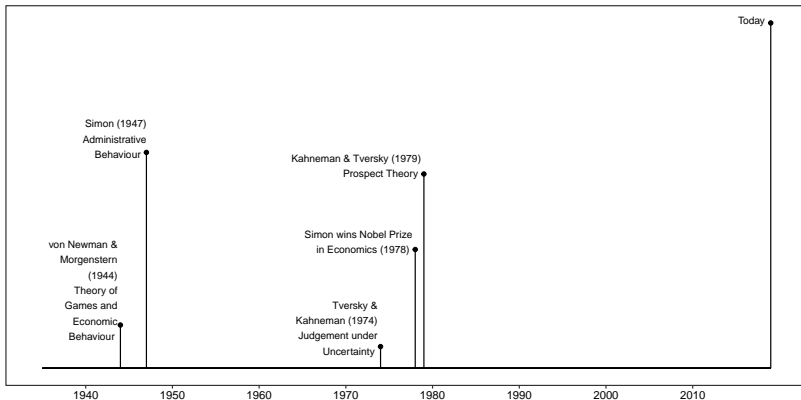
■ Satisficing / Bounded rationality / *homo economicus* ?

Emergence of Economic Psychology



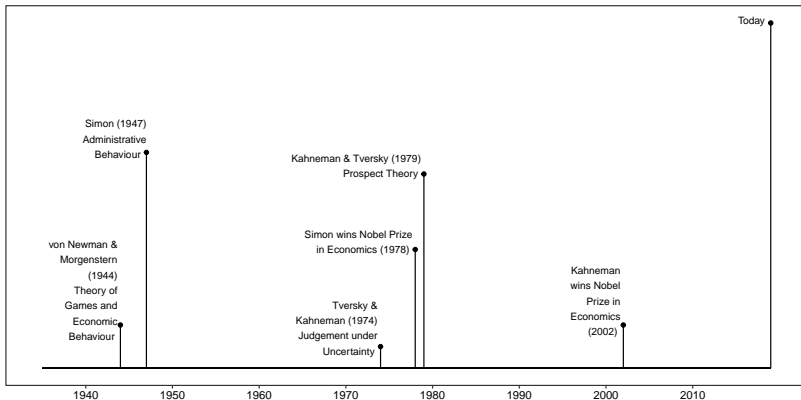
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Emergence of Economic Psychology



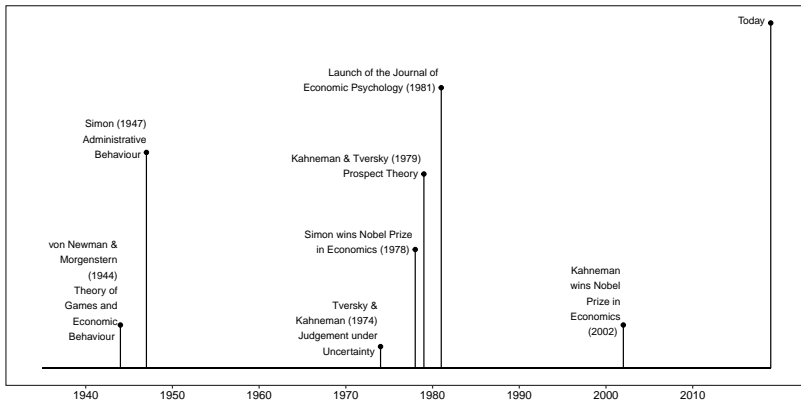
- demonstrating difference from *homo economicus*

Emergence of Economic Psychology



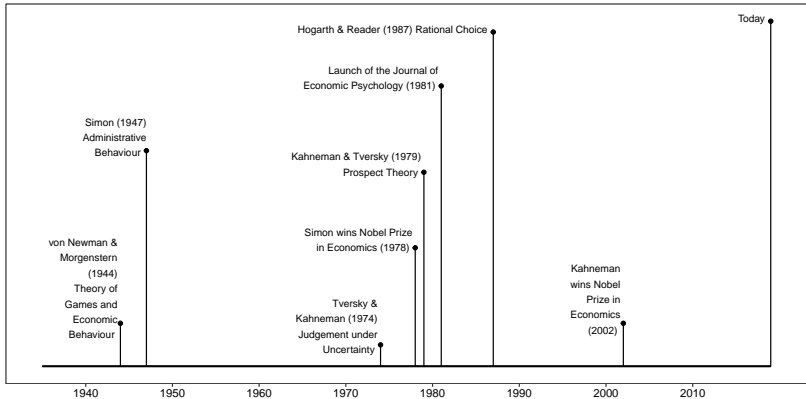
- demonstrating difference from *homo economicus*

Emergence of Economic Psychology



■ Launch of Journal of Economic Psychology

Emergence of Economic Psychology



■ Influential Publication

Approaches to Studying Decision Making

- Normative Theories *versus* Behavioural Theories
- Normative (prescriptive) approaches
 - Influenced by economic and mathematical models of how decisions ***should*** be made
 - Assume people are rational
 - should make the optimal choice (the choice that best reflects the person's preferences)
 - decisions should be consistent across settings
- Behavioural (descriptive) approaches
 - Describe how decisions are made

Defining Rationality

- Epistemic rationality
 - Rational belief or inference
 - Has a conclusion that is true
- Rationality of action
 - Actions (as opposed to beliefs/inferences)
 - Helps to achieve a goal
- **Instrumental rationality**
 - “our mental states or processes are rational when they help us to achieve our goals” (Over, 2004, p. 3)

Discuss

- Differences between Behavioural Economics and Economic Psychology
- What is Rationality

References

- Altman, M. (2017). *Handbook of behavioral economics and smart decision-making*. Cheltenham: Edward Elgar.
- Camerer, C., Loewenstein, G., & Rabin, M. (Eds.). (2003). *Advances in behavioral economics*. Princeton, N.J. ; Princeton University Press.
- Cartwright, E. (2014). *Behavioral economics*. New York: Routledge.
- Lea, S. E. G., Tarpy, R. M., & Webley, P. M. (1987). *The Individual in the Economy: A Textbook of Economic Psychology*. Cambridge Cambridgeshire ; New York: Cambridge University Press.
- Over, D. E. (2004). Rationality and the Normative/Descriptive Distinction. In N. Harvey & D. J. Koehler (Eds.), *Blackwell handbook of judgment and decision making* (1st ed., pp. 3–18). Malden: Blackwell.